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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of The Army

Army's Progress In Implementing The Federal Managers' Financial Integrity Act

GAO reviewed 23 federal agencies' continuing efforts to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse in the federal government through annual agency assessments of internal controls and accounting systems and correction of systems' weaknesses.

This report focuses on the Army's progress and efforts to correct identified weaknesses in its internal controls and accounting systems and efforts to improve its assessment program.

GAO/NSIAD-85-149
SEPTEMBER 27, 1985

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-216946

The Honorable John O. Marsh, Jr.
The Secretary of the Army

Dear Mr. Secretary:

This report presents the results of our review of the Army's progress in its continued efforts to implement and comply with the Federal Managers' Financial Integrity Act (FIA) of 1982 [31 U.S.C. 3512(b) and (c)], which is aimed at strengthening internal controls and accounting systems. The act is a result of a government campaign to improve control over its operations and to protect and safeguard federal dollars by reducing fraud, waste, abuse, and mismanagement. The review was part of our governmentwide assessment at 23 federal departments and agencies.

The Department of Defense's (DOD's) implementing instructions require each component to submit two annual reports to the Secretary of Defense. The instructions require one report to state whether systems of internal accounting and administrative controls, taken as a whole, fully comply with the act's requirements. The act requires that controls be established in accordance with the Comptroller General's standards and provide reasonable assurance that (1) obligations and costs comply with the law, (2) assets are safeguarded against waste, loss, unauthorized use, or misappropriation, and (3) revenues and expenditures are properly recorded and accounted for. Any material weaknesses, along with plans and schedules for their correction, must also be reported if controls do not fully comply with the act's requirements. The second report must state whether accounting systems conform to the principles, standards, and related requirements prescribed by the Comptroller General (hereinafter referred to as the Comptroller General's requirements).

The objectives of our review were to

--determine whether actions taken as a result of the act are improving internal controls and accounting systems;

--evaluate Army's progress in implementing its program for evaluating its internal controls and accounting systems; and

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--assess the adequacy of the basis for determining that the requirements of the act have been met and that accounting systems do or do not conform with the Comptroller General's requirements.

Appendix I contains information on the objectives, scope, and methodology of this review. A glossary of terms used in this report is included as appendix V.

In determining whether an agency has an adequate basis for reporting that it meets the requirements of the act, we believe the agency head must consider the (1) significance of the weaknesses disclosed, (2) status of corrective actions, (3) comprehensiveness and quality of the management control evaluation work performed, and (4) extent to which accounting systems conform to the Comptroller General's requirements.

Your November 1984 report to the Secretary of Defense stated that the Army's systems of internal accounting and administrative control, taken as a whole and in effect during fiscal year 1984, provided reasonable assurance that the objectives of the act were achieved. Eighty-two material weaknesses were disclosed along with completed or planned corrective actions. Your report also identified two complete accounting systems in the Army--one for military functions and one for civil works functions. You reported that 20 of the 66 operating accounting subsystems, including the civil works accounting system, substantially conform to the Comptroller General's requirements. In addition, you reported several major problems with the Army's accounting systems and defined plans for corrective actions to achieve conformance.

We found that the Army's program for evaluating its internal controls was in a year of transition. In March 1984, the Army initiated an extensive redesign of the program to better align it with management procedures. The original program was decentralized, requiring both line and staff managers to conduct vulnerability assessments and internal control reviews for each functional area at each installation or similar organizations. These procedures did not adequately consider the operating environment controlled by standard Army regulations and systems for each functional area nor the differing responsibilities and capabilities of staff and line organizations. In an effort to eliminate redundancies and inadequacies in the decentralized program, the Army elevated the responsibility for its internal control program to functional experts on the Army staff--the same people who issue Army regulations. This centralized approach requires staff managers at Army headquarters to conduct vulnerability assessments and design internal control review checklists on the functions for which they are responsible. The checklists are to be used by operating managers, Army-wide, in

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testing internal controls. In effect, the checklists, when completed, will permit the operating-level manager to test the internal controls required by regulation for each task, and to determine if they are in place and operative or to identify weaknesses needing corrective action.

The Army's evaluation effort in 1984 was a mixture of the "old" and the "new" procedures. Operating managers in the field continued to perform vulnerability assessments and conduct internal control reviews of highly vulnerable areas under the old procedures. They were also asked to correct known weaknesses and to use alternate methods, such as existing quality control programs, internal reviews, and audits to evaluate internal controls. The assurance statements from the operating managers were based on these old procedures. Under the new procedures, the staff offices responsible for specific functional areas conducted Army-wide vulnerability assessments and began developing internal control review checklists for use by the operating managers. The staff offices' annual statements were based on efforts under the new process and, because checklists were not fully developed, other forms of evaluation.

Because the Army's system was a combination of the old and new procedures, a coordinated Army-wide analysis of the various functions was not achieved. Instead, the Army relied heavily on other sources for determining the status of its internal controls, such as management reviews and published audit reports. These are legitimate sources; however, when they are the primary source, we do not believe they provide an adequate basis to assure the requirements of the act have been met. Assuming the continued commitment of Army management to the requirements of the act, the new system, when fully implemented, should provide an adequate basis for assessing its internal controls.

STRONG MANAGEMENT COMMITMENT RESULTS IN MANY WEAKNESSES BEING REPORTED

The requirements of FIA cannot be achieved if managers are not committed to meet them. We believe Army managers are committed to the program and are willing to report material weaknesses and planned corrective actions. In your annual assurance letter to the Secretary of Defense, you disclosed 51 material weaknesses discovered in fiscal year 1984 and 31 material weaknesses discovered in fiscal year 1983. Because of the interim status of the program, most of these weaknesses were identified by Army managers using sources other than internal control reviews, such as audits and inspections. Identifying, coordinating, and reporting on these weaknesses from such a wide variety of sources exemplifies the strong commitment we found Army managers to have.

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Because of the method of reporting--rolling up weaknesses from installations through major commands to the Secretary of the Army--many of the individual weaknesses identified are location-specific. However, when put together, these individual weaknesses represent many of the major issues confronting the Army today. For example, the Army reported a wide variety of weaknesses in areas such as acquisition management, information management, supply activities, and financial management. Some of the weaknesses reported in these and other issue areas and their significance are shown in the table below. A complete listing of material weaknesses reported by functional area is in appendix IV.

1984 Reported Material Weaknesses	Significance or Risk of the Problem
Acquisition Management	
Weapon system integration procedures are inadequate.	The potential for schedule delays, increased costs, and/or technical performance deficiencies has been created.
Civil Works Activities	
Guidance for recreation facilities and visitor centers needs strengthening.	Operation and maintenance expenses and construction costs could have been reduced.
Facilities Support	
Contingency plans for emergency utility support in European military communities and estimating procedures for coal requirements were inadequate.	Combat readiness during emergencies could be adversely affected due to uncertainties about utility support. Also, in fiscal year 1982, $1.5 million in unneeded coal was purchased and thousands of tons of excess coal were on hand.
Financial Management	
The benefits from some existing warranties may not be worth the cost.	Preliminary reviews suggest that better guidelines could result in reduced costs of materials and services.
Health Care	
The radiation protection program needs improvement.	Lack of qualified staffing could lead to a radiation incident, adverse publicity, and destruction of mission essential resources through accidental contamination.

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1984 Reported Material Weaknesses	Significance or Risk of the Problem
Information Management	
Automation management policies and practices require strengthening.	Weak practices have resulted in ineffective use of automation resources, lack of competition, and system development costs which exceed approved cost limitations.
Supply Activities	
The M55 Rocket Disposal Program presents hazards.	Stockpiles of obsolete rockets pose significant storage hazards, unnecessary storage costs, and a major disposal problem affecting six different storage locations.

Reporting material weaknesses is only a part of the process. The intent of the act is to correct the weaknesses, or stated simply, fix the problem. Again, Army managers appear to be committed to the goals of the act. Their annual assurance letters reported the following material weaknesses and status of corrective actions:

1983/84 REPORTED MATERIAL WEAKNESSES

Weaknesses Reported	Corrective Actions Completed	Corrective Actions In Process
1983		
31	9	22
1984		
51	12	39

The scope of our work did not allow us to evaluate the effectiveness of the corrective actions Army-wide. However, our visits to the various commands verified that actions to correct local problems are being taken. For example,

--Ammunition and weapons control: At Fort Sam Houston, Texas, $250,000 worth of ammunition and weapons on-hand were in excess because procedures to ensure that material on-hand did not exceed current requirements were not followed.

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--Corrective action: Excess materials were sent to other locations, and inventories were performed.

--Travel pay operations: Weaknesses were reported at two major commands (Training and Doctrine Command and Forces Command) and one installation (Fort Bragg), relating to the inability to challenge travelers' expenses, errors in calculating travel vouchers, and inadequate tracking system for travel payments.

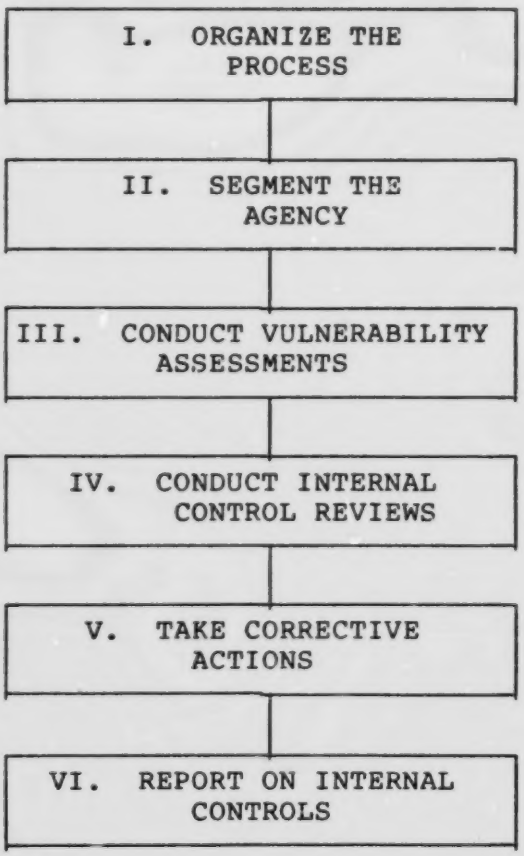
--Corrective action: Travel regulations were amended, local training of staff was provided, and travel processing is being automated.

PROBLEMS WITH THE ARMY'S EVALUATION PROGRAM

In order to successfully continue to meet the requirements of FIA, Army management should focus on the difficulties experienced in its internal control evaluation program. The problems we noted affect various steps of the evaluation process.

The steps of the internal control process--segmentation, vulnerability assessments, internal control reviews, etc.--are like building blocks, each dependent on the other. The quality of one step affects the other subsequent steps. The results of the process should form the basis for the assurance letters to the Secretary of Defense, the President, and the Congress. The Army believes, and we concur, that this self-examining process may uncover inefficient or overcontrolled areas, the correction of which could free resources for more productive uses. Therefore, the proper execution of each step is extremely important to the successful implementation of the internal control program.

FIA PROCESS


I. ORGANIZE THE PROCESS
II. SEGMENT THE AGENCY
III. CONDUCT VULNERABILITY ASSESSMENTS
IV. CONDUCT INTERNAL CONTROL REVIEWS
V. TAKE CORRECTIVE ACTIONS
VI. REPORT ON INTERNAL CONTROLS

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With the extensive redirection of its program, the Army experienced several problems during implementation which we believe were caused by inconsistent and unclear guidance. For example, field managers received two different sets of interim guidelines which caused varied approaches toward program implementation. Further, we believe unclear guidance was responsible for the lack of supporting documentation for vulnerability assessments, and for only a few locations establishing tracking and follow-up systems. Most important, however, was the failure to provide adequate guidance for defining subfunctions and assessable units. Identifying assessable units is a key preliminary step in the internal control process upon which an adequate internal control program is built. If assessable units are not clearly defined, segments of programs and operations may not be reviewed, and potential weaknesses could remain undetected. In April 1985, the Army issued its revised internal control program regulation which should correct these procedural problems.

We also found that the Army did not adequately evaluate the ADP general and application internal controls during 1984. Although the level of attention given to ADP internal controls improved during 1984, the process and procedures to review the controls did not exist for most of the fiscal year. The recent assignment of ADP responsibilities to the Assistant Chief of Staff for Information Management should resolve most of the organizational problems we found during our review. The Army's adoption of the ADP guidance issued by the Secretary of Defense in November 1984, should help resolve the procedural problems.

STATUS OF ACCOUNTING SYSTEMS

During fiscal year 1984, the Army developed a comprehensive inventory of all its accounting systems. Its effort to establish and validate the inventory was comprehensive and helped to ensure that all major accounting activities were identified and included in the inventory.

The Army also initiated a comprehensive evaluation of all of its accounting systems to determine whether they conform with the Comptroller General's requirements. However, only 2 to 3 months were allotted to do the evaluations, including testing. Further, specific evaluation instructions were not provided until late in the fiscal year. The result was inconsistent and incomplete evaluations. We believe the Army could have avoided these problems and better used its resources by prioritizing its reviews. For example, accounting systems considered to be of higher risk potential could have been evaluated first, while systems scheduled for early replacement could have been scheduled for later review. The Army plans to continue to evaluate its accounting systems to determine conformance for annual reporting under FIA.

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Your annual assurance letter reported two Army accounting systems--one for military functions and one for civil works functions. The letter cited significant problems within the military system and stated that it did not meet the Comptroller General's requirements as required by the act. It also stated that 20 of the 66 subsystems (which include the civil works system) substantially conformed with the requirements, although some problems were cited, and that the 46 non-conforming subsystems had financial controls and reporting features to accomplish the Army's fiscal accounting responsibilities. According to an Army official, fiscal accounting responsibilities refer to administrative and accounting controls over funds appropriated by the Congress.

We believe your letter correctly cited the major problems in the military system. The Army plans to correct these problems as part of a major ongoing redesign program. However, because of the extensive amount of work and the limited time allowed for performing the evaluations, and the limited testing of transactions, we do not believe these evaluations provided a sufficient basis to determine that 20 of the 66 military subsystems met the Comptroller General's requirements, or to ensure that the controls in the nonconforming subsystems provide adequate administrative and accounting control over appropriations. Also, we do not believe the civil works system should have been reported as being in conformance until the known deficiencies have been corrected. The Army's progress in reviewing the accounting operations is discussed in appendix III.

Military accounting systems

The major military accounting systems' deficiencies reported by the Army in 1984 were essentially the same as those reported in 1983--inadequate general ledger control and reporting, incomplete property and cost accounting, inadequate documentation, inefficiency in the processing of data, and poor control over pay entitlements. For example, the Army's evaluation of the Standard Finance System, which accounts for about $15 billion, reported that the general ledger does not provide an adequate basis for trial balances used for consolidating and preparing external reports. In addition, the system lacked procedures to control property transactions and asset transfers, and to ensure the validity of consolidated reports.

The Army's evaluation of another system, the Headquarters Accounting and Reporting System, which centrally accounts for all the Army's annual obligations of more than $80 billion in fiscal year 1984, identified an inadequate general ledger which does not properly account for the assets, liabilities, and capital. The general ledger does not serve management because it can not be used to control data produced by the system.

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The Army's redesign program represents a major corrective action plan for eliminating the reported accounting systems deficiencies. This program, initiated several years ago, is one of the largest system improvement efforts in the government. The Army plans to complete all of the redesign work in 1989. Current implementation and deployment plans call for 8 subsystems to replace the current invertory of 66 subsystems. The redesigned subsystems are to be installed on an incremental basis as each new subsystem design is completed and installation equipment is obtained. The entire military system is scheduled to be fully operational by the early 1990s. A few subsystems are now operational, and some modules for the departmental level accounting subsystem have been designed. The Army should evaluate any new or redesigned subsystems to ensure that they operate in conformance with the Comptroller General's requirements.

Since the redesign effort is essential to the Army's plans for improving conformance with the Comptroller General's requirements, it should be closely monitored by Army officials for slippage in target dates and continued adherence to project objectives. We recently started a review to assess the redesign program.

Civil works accounting system

You reported that the Army's civil works accounting system is substantially in conformance. You also reported that (1) a recent internal audit of the system identified compliance and procedural problems in current operations and (2) the civilian pay subsystem was not in conformance. Although the Army plans to correct the problems in 1985 and replace the pay subsystem in 1986, in our opinion, the deficiencies disclosed and the nonconforming civilian pay subsystem are serious enough to warrant classifying the civil works system as not in conformance. The audit findings and the system relationships are discussed in appendix III.

Tracking and follow-up system

The Army's follow-up system for tracking accounting system deficiencies and related corrective actions is a manual system with limited information. Army officials have recognized the need for a better system and have requested automated equipment to support the operation of such a system.

At a minimum, we believe that the following information should be considered in the follow-up system: (1) the deficiencies in systems and subsystems, (2) planned corrective actions, including system replacement plans, (3) the office responsible for the corrective actions, (4) interim and final milestone dates for the corrective actions, (5) slippages of scheduled

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corrective action work, and (6) identification of whether the action taken actually corrected the deficiency. With this information, we believe that Army officials can effectively monitor the reported deficiencies and related corrective actions.

CONCLUSIONS

Although the Army's new program was not yet in place, the Army did a commendable job in its efforts to implement the act. The Army reported that its internal accounting and administrative controls, taken as a whole, provide reasonable assurance that the objectives of the act were achieved. Because of the magnitude of the Army's program, it can be expected that differing opinions would exist on the adequacy of its basis for determining the status of its internal controls. Certainly this judgment is difficult to make. Although the basic framework for an effective program has been established within the Army, we believe more must be done before it will provide an adequate basis for determining that internal controls meet the requirements of the act.

Many problems encountered during implementation of the act affected the basis for reporting. We believe most of these problems stemmed from unclear or inconsistent guidance. Unclear guidance contributed to problems in defining assessable units, documenting vulnerability assessments, and establishing tracking and follow-up systems. Inconsistent guidance contributed to the differing approaches to program implementation. The Army's revised internal control regulations, the adoption of DOD's ADP guidance, and organizational changes should alleviate many of these problems. We are, therefore, not making any recommendations in these areas. However, the Army needs to monitor the implementation of the new guidance to ensure that it is meeting the needs of managers and is being implemented Army-wide.

Regarding the accounting systems, we believe that (1) the Army's review of its systems was insufficient to support the conclusion that 20 of the subsystems conformed with the Comptroller General's requirements and that the non-conforming subsystems had financial controls to ensure that all fiscal responsibilities were being met, (2) the civil works system was not operating in conformance as reported, (3) the Army should reconsider its systems' review methodology and adopt a system that ensures the high risk accounting systems receive priority in scheduling evaluations, and (4) the Army should move forward with its follow-up system to track deficiencies and corrective actions in individual systems and subsystems.

The internal control process can be a valuable management tool in better managing precious resources. The results of this process are meant to be represented in the annual assurance

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letter to the Secretary of Defense, and ultimately, to the President and the Congress. With continued management attention and the adoption of the following recommendations, we believe that the Army's internal control program can provide a better basis for identifying and correcting internal control weaknesses.

RECOMMENDATIONS

We recommend that the Secretary of the Army not report that the Army's systems of internal accounting and administrative control meet the requirements of the act until the evaluation program has developed to the point where a coordinated Army-wide analysis of all functions is performed. Also, we recommend that the accounting systems not be reported as (1) being in conformance with the Comptroller General's requirements and (2) providing adequate financial control and reporting features to support the Army's fiscal accounting responsibilities, until they have been tested in operation. We further recommend you direct that

- --a comprehensive tracking and follow-up system be established and used to ensure correction of accounting systems deficiencies before the systems are reported in conformance, and

- --the civil works accounting system not be reported as in conformance until known system problems are corrected and the related civilian pay system is brought into conformance.

AGENCY COMMENTS AND OUR ANALYSIS

DOD's official comments on our draft report are contained in appendix VI. DOD disagreed with our conclusions and related recommendations concerning the adequacy of the Army's basis for determining that its internal control systems, taken as a whole, meet the requirements of the act, and that accounting systems conform with the Comptroller General's requirements. DOD also disagreed with our recommendation that the Army should prioritize its accounting systems reviews. However, it did agree with our recommendations to establish a comprehensive tracking and follow-up system to monitor accounting systems' corrective actions and to consider existing problems in the civil works accounting system before reporting it in conformance.

Disagreement on the basis for determining that requirements of the act had been met

We recommended that the Army not report that its internal control systems meet the requirements of the act until a coordinated Army-wide evaluation of all functions can be achieved.

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Our report points out that 1984 was a year of transition in the Army, as it moved toward a more centralized internal control evaluation program. We also recognized the supportive attitude of top Army managers towards the act's objectives, and that Army managers have been forthright in identifying control problems and in working toward solutions. However, an objective of our review, as well as similar reviews at 23 other federal agencies, was to "step back" from all these efforts and comment on the adequacy of the Army's basis for preparing its 1984 assurance letter to the Secretary of Defense. We concluded that the Army did not have an adequate basis for its reasonable assurance statement because it had not yet progressed far enough in fully implementing its new centralized evaluation program.

DOD disagreed and stated that Army managers have an adequate basis for determining that the requirements of the act have been met. Army's assurance was provided by the field managers' ongoing efforts under the old program (which produced thousands of vulnerability assessments and internal control reviews), information from other control techniques, such as audits and inspections, and headquarters managers' efforts under the new program.

As stated before, our objective was to assess the condition of Army's program at the end of 1984. The many thousands of vulnerability assessments and internal control reviews cited by the Army were being performed by field level managers using program guidance that both the Army and we had agreed in early 1984 should be revised to provide a better basis to determine if the controls, taken as a whole, met the act's requirements. Representatives from both our office and OMB agreed that discontinuing field managers' involvement during the transition period would waste the momentum gained by the Army. Therefore, we agreed that the Army should continue its efforts under the old decentralized system until the new system could be implemented.

In summary, we agree with the Army's decision to centralize its internal control evaluation program. In our opinion, such an Army-wide evaluation of each functional area, if properly implemented in the future, should be capable of providing an adequate basis for assessing the overall status of internal controls and deciding if the requirements of the act have been met. During the 1984 reporting period, however, no functional checklists were completed and no functions received this Army-wide, systemic evaluation that we believe is necessary. We therefore continue to believe that the Army did not have an adequate basis to determine that the objectives of the act have been met.

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Disagreement on determining accounting systems conformance

DOD did not agree with our recommendation that accounting systems not be reported as (1) being in conformance with the Comptroller General's requirements and (2) providing adequate financial control and reporting features to support the Army's fiscal accounting responsibilities, until the systems have been tested in operation. DOD stated that during 1984, the Army developed and implemented a very comprehensive and sound methodology for identifying, evaluating, and reporting on operating accounting systems.

We found that although the Army did develop a comprehensive methodology for evaluating accounting systems, which called for testing of transactions and quality assurance reviews of the evaluations, the problem was inadequate implementation of the methodology. The Army sent the methodology to the commands during late July 1984, and the evaluation reports were due October 1, 1984. We obtained information on the Army's evaluation of 20 subsystems and found that most of the evaluations contained no transaction testing, or only limited transaction testing. Also, we found that quality assurance reviews had not always been performed. For example, one Army command reported that it had not performed quality assurance reviews on 24 of its 25 subsystems. Given the incomplete and ineffective implementation of its methodology during the 1984 evaluation cycle, we continue to believe the Army did not have a sufficient basis to determine if its systems conformed with the Comptroller General's requirements or whether the systems provided adequate financial controls and reporting features to support Army's fiscal accounting responsibilities.

In commenting on our report on DOD's implementation of the act[1], DOD stated that it will soon issue policy guidance for accounting systems' evaluations, and that future certification statements signed by component heads must indicate that the certifications are based upon transaction testing of systems. In commenting on our Army draft report, DOD also stated that the Army's fiscal year 1985 instructions to its accounting systems managers emphasized testing as a key element in the evaluation of those systems planned to be reported in compliance with the prescribed standards. If the Army properly implements its instructions and the DOD guidance, it will satisfy the intent of our recommendation.

DOD also disagreed with a proposal in our draft report that an accounting system review plan be devised to prioritize subsystem reviews according to such relative risks as when the

[1]Department of Defense's Progress in Implementing the Federal Managers' Financial Integrity Act (GAO/NSIAD-85-147, Sept. 30, 1985, App. VI).

subsystems will be replaced, and the subsystems' significance to the Army's total fiscal responsibilities. DOD noted that systems evaluations are performed by the responsible system managers concurrently, and are mutually exclusive from one another, therefore negating the requirement for a single prioritized listing. Further, the Army revised its procedures in April 1985 to require that the level of evaluation depends on whether managers intend to report the system in conformance, and the Army accounting systems evaluation criteria now provides for a lesser evaluation of systems known to be in nonconformance and scheduled for replacement. Because the Army has recognized that different levels of evaluations can be performed, depending on the subsystem's conformance and replacement status, we did not include this proposal in our final report.

. . . . .

As you know, 31 U.S.C. §720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Chairmen of the above committees; and to the Chairmen of the House and Senate Committees on Armed Services, and the Budget. We are also sending copies to the Director, Office of Management and Budget, and to the Secretary of Defense.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Director

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ABBREVIATIONS

ADP	Automated Data Processing
DOD	Department of Defense
FIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office

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OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were to

--determine whether actions taken as a result of the act are improving internal controls and accounting systems;

--evaluate Army's progress in implementing its program for evaluating systems of internal control and accounting; and

--assess the adequacy of the basis for the Army's determining that the requirements of the act have been met and that accounting systems do or do not conform with the Comptroller General's requirements.

Our work was conducted from June 1984 through March 1985. We visited the following Army locations during our review:

ARMY SECRETARIAT

Assistant Secretary of the Army for Financial Management
Office, Chief of Public Affairs

ARMY STAFF OFFICES

Office of the Chief of Staff
Selected Army Staff Offices

ARMY COMMANDS

Headquarters, U.S. Army Forces Command, Atlanta, Georgia
Headquarters, U.S. Army Materiel Command, Alexandria, Virginia
Headquarters, U.S. Army Training and Doctrine Command, Hampton, Virginia
Headquarters, Eighth U.S. Army, Korea
U.S. Army, Japan
U.S. Army Western Command, Hawaii
U.S. Army Information Systems Command, Fort Huachuca, Arizona

We also visited selected installations of the various commands. To be consistent with the Army's redirected internal control program, we concentrated our efforts on the new program. To accomplish our objectives, we

--reviewed Army's internal control regulations, directives, and correspondence;

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--reviewed a sample of vulnerability assessments and supporting workpapers (when available) performed by staff offices, and interviewed officials who completed the assessments;

--reviewed a sample of vulnerability assessments and internal control reviews (performed under "old" fiscal year 1983 process) at three Pacific commands;

--interviewed key officials appointed to coordinate the internal control program and other officials involved in implementing the program;

--followed up on selected fiscal year 1983 internal control weaknesses to determine the status of corrective actions.

We did not evaluate the effectiveness of internal controls or corrective actions taken to improve weaknesses because time did not permit the in-depth analysis required to make such an assessment.

We limited our evaluation to an examination of the Army's process for determining operating accounting systems conformance with the Comptroller General's requirements. We reviewed the Army's guidance for evaluating accounting systems conformance. We reviewed the implementation of this guidance for 11 of the 66 accounting subsystems by interviewing appropriate Army officials and examining the Army's documentation to support the evaluation determinations. We received information via questionnaires on the evaluation process for nine additional accounting subsystems, and we reviewed all of the accounting subsystems feeder reports submitted for fiscal year 1984.

Our work was closely coordinated with the Army Audit Agency, and we used the results of their reviews when possible.

During the course of our review, we regularly informed agency officials of the positions taken in our report so they could consider our views in planning their 1985 FIA implementation effort. This review was conducted in accordance with generally accepted government auditing standards.

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OBSERVATIONS ON THE ARMY'S ABILITY TO SUCCESSFULLY EVALUATE ITS INTERNAL CONTROLS

As discussed in this report, the Army has initiated a major revision to the evaluation program in an attempt to better align it with the way the Army is managed. The Army has experienced several problems that have impeded progress toward full implementation of the program. Several areas where the Army needs to improve its process are discussed below.

SEGMENTATION

The segmentation process involves dividing an agency into organizational components and administrative functions in order to establish an agencywide inventory of assessable units. A complete and accurate inventory of assessable units is an essential step in the evaluation process, since the development of vulnerability assessments and internal control reviews is dependent on the functions identified for evaluation.

Under its new system, the Army organized its evaluation process totally on a functional basis. This resulted in the definition of 27 functions which, according to Army officials, cover its activities. The Comptrolier of the Army was given overall responsibility for administering the FIA program. Each of the other staff offices was assigned responsibility for implementing FIA in functions for which they have cognizance. Their responsibilities included segmenting each function into subfunctions to develop an inventory of assessable units. As each assessable unit was defined, the staff office was to perform a vulnerability assessment and begin to develop an internal control review checklist.

Defining these subfunctions was difficult for many of the staff offices. Some offices omitted major activities in their functions, others could not decide on a firm listing of subfunctions, and still others defined them at too broad a level to be useful for evaluation. For example, the Surgeon General's Office identified "Health Care in Defense Facilities," "Health Care in Non-Defense Facilities," and "AMEDD Special Programs and other Medical Activities"--three very broad categories.

We found that as late as September 1984--1 month before the command and staff office annual statements were submitted to the Army Internal Control Office--only 5 of the 16 staff offices had prepared inventories of assessable units. For example, staff within the Office of the Assistant Chief of Staff for Intelligence did not prepare an inventory because they did not believe that the guidelines for identification of assessable units were sufficiently definitive.

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We would expect some confusion and/or uncertainties in the definition of the subfunctions and assessable units because of the Army's redirection of the FIA evaluation program. We would not expect functions to remain static. However, we believe that if the Army is to meet its goal of implementing the FIA program quickly, it should closely monitor compliance with its recently issued guidance.

VULNERABILITY ASSESSMENTS

A substantial number of vulnerability assessments were completed, however, little supporting documentation was found. The results of vulnerability assessments, internal control reviews, and follow-up actions are an important basis for the assurances provided by the Secretary of the Army. Documentation that provides a record of what was accomplished is an essential element for the successful operation of an internal control program. It should contain sufficient detail to permit effective supervisory review, quality review by management, and audit oversight.

We evaluated 50 of 251 assessments[2] completed by staff offices and found that 82 percent had no supporting documentation, other than the assessment form itself. We believe this was caused by a lack of clear guidance. The assessments included the evaluation steps suggested in the Office of Management and Budget guidelines, but did not (1) explain how assigned rankings were determined, (2) describe how functional areas were assessed, (3) define the amount of funds involved in the function, or (4) describe the methodology used and the support for conclusions reached.

INTERNAL CONTROL REVIEWS

Although 17,000 internal control reviews were completed in 1984, none were completed under the Army's redesigned process, which requires the development of internal control review checklists. These checklists are, however, being planned and developed. Based on existing regulations, the checklists form the first phase of an internal control review. Once the checklists have been developed by staff offices, they will be executed by operating managers in the field. The Army plans to continue to operate a decentralized and a centralized internal control system until most of the checklists have been completed.

Testing of control techniques is the final, and perhaps the most important step in the internal control review, since its purpose is to determine whether internal controls are functioning as intended. Without this important step, we believe a comprehensive evaluation of internal controls cannot be made. The

[2]Figure represents number of assessments completed as of Sept. 1984.

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scope of our work concentrated on the Army's redirected process. Since the checklists had not been completed, we could not evaluate how well they address the need for testing of control techniques.

TRACKING AND FOLLOW-UP

The purpose of the act is to improve agency internal control systems; prevent and detect fraud, waste, abuse, and mismanagement; and increase the efficiency and effectiveness of federal agency operations and programs. This can only be accomplished if appropriate and timely corrective actions are taken on all significant weaknesses in internal control systems. A tracking and follow-up system is mandatory to ensure that the goals of the act have been achieved. A good system should be able to log and track all planned corrective actions; identify responsible personnel and target dates; and help management to monitor progress made in implementing corrective actions.

We found the Army has been slow in establishing tracking and follow-up systems at staff offices and major commands. Excluding the Auditor and Inspector General's offices, only 4 of the 16 staff offices and 2 of 10 activities we visited had established tracking and follow-up systems. We believe that at least one reason for this is a lack of definitive guidance. The Army's guidance did not specifically assign responsibility for tracking and follow-up--it only alluded to managers/functional proponents as being the responsible parties. In our opinion, responsibility must be specifically assigned if the Army expects to achieve its goals for its new internal control program. The Army's 1985 internal control guidelines require managers to meet milestone dates to correct material weaknesses. The Auditor General and the Inspector General are also tasked with determining, during the normal course of audits and inspections, whether management corrects material weaknesses, and alleviates internal control problems.

Army officials informed us that its current guidelines provide the specific instructions necessary to establish an effective tracking and follow-up system. Rather than have Army staff offices, major commands, and other organizations develop individual tracking and follow-up systems, Army officials decided to develop a centralized and fully integrated automated system. The system when implemented will provide an audit trail from the centralized records to the lowest level organization. Development of this system began in 1984 and is scheduled to be operational by the end of 1985. As a result, it was not included in our review. However, if the system operates as stated by Army officials, it should provide the information necessary to assure any internal control problems are corrected.

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ADP GENERAL AND APPLICATION CONTROLS

The Army is highly dependent on computers to carry out its mission and administrative functions. The Army mission and many of its functions, such as personnel, payroll, supply, and command and control would be difficult to perform effectively without the aid of computers. Associated with the use of automation are elements of risk which can increase chances for the occurrence of fraud, waste, and abuse. Internal controls can be used to identify and reduce these potential risks. It is, therefore, necessary to review and evaluate the functioning of ADP internal controls to ensure these risks are minimized.

The Army considers its automation activities to be a highly vulnerable area. While many of the problems we identified in our May 1, 1984, report on the implementation of FIA have been corrected, the Army's program to review its ADP general and application controls is still evolving. A staff office has been assigned responsibility for automation activities, and guidelines for evaluating general and application controls for automated systems have been issued. General controls will be incorporated into evaluation checklists developed by the functional proponents responsible for the automation activities subfunctions. Application controls contained in standard automated and manual systems, which support Army subfunctions, will be incorporated into the checklists developed by the functional proponents responsible for those subfunctions. Finally, DOD's detailed guidance for the evaluation and review of ADP internal controls, issued in November 1984, is being distributed throughout the Army. In our opinion, this document provides a good discussion on managers' responsibilities for ADP internal controls and ADP control objectives and techniques.

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CONFORMANCE EVALUATIONS OF ACCOUNTING SYSTEMS--TOO MUCH, TOO FAST

During fiscal year 1984, the Army initiated evaluations to determine whether its accounting systems were in conformance with the Comptroller General's requirements. We question the reliability of the evaluation effort because the process was performed in too short a time period for the amount of work required. Further, the deficiencies disclosed in the civil works system were not adequately considered in determining conformance of that system.

ACCOUNTING SYSTEMS CONFORMANCE EVALUATION SCOPE WAS UNREALISTIC

The Army decided to review all of its accounting systems and subsystems during fiscal year 1984. An Army official advised us that this effort might increase management interest and emphasis on accounting controls. The Army's decision to evaluate all of its accounting systems and subsystems was unrealistic because the time allotted--2 to 3 months--in fiscal year 1984 was insufficient to do the massive review involved. The Army could have better used its resources by estimating the potential problems and risks in each subsystem and scheduling the evaluations of those higher risk subsystems. For example, evaluations of subsystems scheduled for early replacement, or evaluations which did not include significant accounting operations could have been avoided or limited in scope. Those subsystems scheduled for retention or later replacement could have been given priority and more complete reviews.

The Army did not provide specific evaluation instructions to its reviewers until late in the fiscal year. However, the reviewers were expected to complete the systems evaluations, including testing, and prepare their evaluation reports by the end of the fiscal year. The instructions included a 162-page review checklist, instructions on how to complete the conformance evaluations, suggestions on testing methodology, and reporting requirements. These instructions were distributed during late July 1984 and the evaluation reports were due October 1, 1984. Specific reporting requirements and formats were included in the instructions. Reports on subsystems deemed in conformance were to include the basis for the determination. For those subsystems reported as not in conformance, reviewers were required to identify system deficiencies, interim corrective actions, and planned systems replacement.

Each subsystem review was to be accomplished in three sequential steps: (1) a detailed review by a system reviewer, or reviewers, familiar with the subsystem and the requirements, (2) a review of the first reviewer's workpapers by an

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independent reviewer, and (3) a review of the first and second reviewers' workpapers by a senior level manager. The first reviewer was to complete a 162-page checklist, interview system users, test system operation, including ADP and manual controls, and prepare workpapers to document the review and corrective action being taken or planned, and the conclusions reached. The second reviewer was to review the first reviewer's workpapers for adequacy, statistically validate the first reviewer's responses to the checklist, evaluate corrective actions, and prepare workpapers to document the review and conclusions reached. The third reviewer was to review the first two reviewers' workpapers for adequacy, resolve any differences in conclusions reached by the two reviewers, evaluate corrective actions, and prepare a review report.

The time allotted--2 to 3 months--was insufficient to perform all of the above review work. For example, an official of an Army command, responsible for reviewing 25 subsystems, advised us that the above review plan required too much work in the amount of time allotted. The command advised the Army's Internal Control Office that the first level reviews for 24 of the subsystems were performed in fiscal year 1984, and the second and third level reviews were to be completed by July 1985. Reviewers of the 25th subsystem completed the first and second level reviews during fiscal year 1984, and planned to complete the third level review by July 1985. Army review personnel at several sites we visited also advised us that insufficient time was allotted for the reviews.

The Army held several training sessions, each lasting about 2 hours, at various locations. Issues covered during these sessions included the approach for using the checklist, documentation requirements, and required testing. During the training session we attended, little time was allotted for in-depth discussions of how to perform the evaluations. Training handouts included examples of how to complete the review guide, develop workpapers, and determine the scope of systems evaluations.

Moreover, our review of some of the actual conformance evaluations disclosed that the review guidance requirements were not always met, and testing of actual transactions was limited. To determine whether a financial system conforms to the Comptroller General's requirements, it is necessary to review and test the system in operation. Although agency personnel may have extensive knowledge, systems may operate differently than they believe. Therefore, testing should be done on critical aspects of the system. A discussion of what we consider to be adequate testing is included in the glossary. (See app. V.)

Army managers were not provided sufficient time or adequate training to complete the systems evaluations as required. As a

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result, there was very little testing of the accounting systems in operation--a critical element of any evaluation. Therefore, we believe that the 1984 evaluation work actually performed did not provide a sufficient basis for the Army to report that 20 of its 66 subsystems are in conformance with the Comptroller General's requirements.

ARMY REPORT SHOULD HAVE DISCLOSED THAT CIVIL WORKS SYSTEM OPERATIONS DID NOT MEET REQUIREMENTS

The civil works system, part of the Corps of Engineers' Management Information System, was included in the Army's fiscal year 1984 system evaluations and reported as operating in substantial conformance with the Comptroller General's requirements.

The Army also reported that recent internal audits disclosed several deficiencies in the system's operations, and the civil works payroll subsystem was not in conformance. The Army justified its report on the grounds that the operational problems were to be corrected in 1985, the payroll subsystem was to be replaced in 1986, and the system design was determined to meet the Comptroller General's requirement.

Although the Army was forthright in recognizing the problems with the civil works system, we do not agree that the civil works system is in substantial conformance. First, the findings identified in the reviews by Army Audit and by us are, in our opinion, significant and could adversely impact on system operations. Several of these findings are

- --insufficient control over cash collection and accounting for accounts receivable;
- --weak administration over the validation, recording, and control of fund accounting transactions;
- --inadequate controls and reviews over disbursements;
- --questionable propriety of other disbursement transactions, including reports of false travel claims; and
- --inadequate controls over travel advances.

Second, the Comptroller General's requirements and the Army's system evaluation instructions prescribe that an agency's payroll system shall be an integral part of its accounting system. Therefore, conformance of the payroll subsystem is a critical factor in determining if the entire system is in

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conformance. Third, while the conformance of the design of an accounting system is important, it is mandatory that systems conform in actual operation. Thus, in our opinion, the Army did not have a sufficient basis to report that the civil works system was in conformance with the Comptroller General's requirements.

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INTERNAL CONTROL WEAKNESSES REPORTED IN FY 1983 AND FY 1984

Material Weaknesses for Which Corrective Actions Have Been Taken (FY 1983)

Contracting

Inadequate internal controls in fast pay contracts.

Procedures for obtaining and evaluating contractors' detailed cost proposals prior to awarding contracts were not always followed or were not adequate.

Weaknesses in delivery orders issued under basic ordering agreements.

Inadequate procedures to assure that data on contractor performance were requested and used to evaluate contractor responsibility.

Financial Management

Internal control weaknesses in the Army Industrial Fund budget procedures.

Inadequate internal controls in the repair or rebuild of foreign-owned military equipment.

Personnel Activities

Policy and procedures were not always followed when selecting personnel for special forces training.

Supply Activities

Inadequate internal controls in spare parts acquisition.

Material Weaknesses for Which Corrective Actions Have Been Taken (FY 1984)

Acquisition Management

Inadequate weapon system acquisition strategies procedures.

Information Management

Inadequate physical security of computer terminals.

Construction Activities

Inadequate and incomplete procedures and insufficiently trained personnel resulted in an understatement of reimbursable costs for support of military construction projects.

Contracting

Inadequately written procedures and guidance for contractors impacts Army's ability to meet its needs.

Financial Management/Accounting Operations

Accounting for foreign military sales needs improvements in some areas.

Financial Management/Active Army Pay Operations

Actions needed to minimize risks in maintenance of the military pay system computer software.

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APPENDIX IV

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Material Weaknesses for Which Corrective Actions Have Been Taken (FY 1983)

Support Services

In planning for new dining facilities at seven installations, excess capabilities in existing facilities were not adequately considered.

Material Weaknesses for Which Corrective Actions Have Been Taken (FY 1984)

Financial Management/Disbursing/Commercial Accounts/Accounting Operations

Lack of sound internal controls in the management of cash, daily cash settlements, and payments to commercial vendors.

Financial Management/Quality Assurance Operations

Undetected errors in examination of vouchers at the U.S. Army Finance and Accounting Center.

Housing

Unneeded Temporary Lodging Allowance payments were made because forecasts of housing availability were not adequate.

Personnel Activities/ Technical Services

Internal controls did not ensure that injury claims submitted to the Department of Labor were investigated, properly supported, and documented.

Personnel Activities

Internal control weaknesses within the Selected Reserve Incentive Program could result in a significant monetary loss to the Government.

Transportation Services/ Rail Operations

Weak reconciliation procedures for rail transportation expenses prevented identification of improper billings, estimation errors, and overcharges.

Material Weaknesses Requiring Corrective Action (FY 1983)

Information Management	Completion Date
Inadequate computer security at several Army data processing activities.	FY 85
Inadequate planning and management in the use of small computers.	FY 87
Support Services	
Lack of accountability for subsistence items.	FY 85
Weak management control by operating 85 commissaries in 7 countries by a single headquarters unit.	FY 86
Inadequate ADP services in the commissary region ADP support system.	FY 86
Financial Management	
A number of internal control weaknesses in travel reimbursements and advances.	FY 85
Internal control weaknesses in the recoupment of nonrecurring costs on direct sales by contractors to foreign customers.	FY 85
Physical security for cash and other sensitive assets needed improvement at several Army locations.	FY 85

Technology Transfer	Completion Date
The current western technological edge is vulnerable to the Soviet program to acquire western technology.	FY 85
Maintenance Activities	
Maintenance expenditure limits for tactical wheeled vehicles have not always been based on cost experience.	FY 87
Policy procedures were not adequate to prevent possible overstockage of Operational Readiness Float Material.	FY 85
Personnel Activities	
Management controls over the civilian retirement program were not effective.	FY 85
Contracting	
Staffing and training in the procurement area is deficient at numerous locations, resulting in the Army not always receiving full value for procurement dollars expended.	FY 85
Supply Activities	
Policy and procedures to manage war reserve stock have not been implemented effectively, and methods for distribution to Reserve Forces were inadequate.	FY 85

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Material Weaknesses Requiring Corrective Action (FY 1983)

Financial Management (continued)	Completion Date
The Army's military accounting system does not conform to the accounting principles, standards, and related requirements prescribed by the Comptroller General.	FY 86
Weak procedures to account for unused passenger tickets.	FY 85

Supply Activities (continued)	Completion Date
Inadequate internal controls over Government-furnished material and property in the hands of the contractors.	FY 85
Inadequate supply management system.	FY 87
Inventory control weaknesses in a number of areas.	FY 86
Transportation	
Procedures are inadequate to reconcile and report discrepancies between actual and manifested quantities of accountable dunnage and lashing material.	FY 85
Cost analyses supporting the selection of transportation services for small lots of hazardous or sensitive cargo need improvement.	FY 85
Management Activities	
Lack of a comprehensive installation management information system contributes to inefficient management practices.	FY 87

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Material Weaknesses Requiring Corrective Actions (FY 1984)

Acquisition Management	Completion Date
Inadequate weapon system integration procedures.	FY 86
Improvements needed in the Army Systems Acquisition Review Council process.	FY 86
Inactive industrial plant equipment is not maintained in immediate use condition.	FY 85
Unclear guidance in using instrumentation funding.	FY 85
Duplication of effort in exploratory development work.	FY 84
Lack of effectiveness in US Army Materiel Command Research and Development labs.	FY 87
Civil Works Activities	
Guidance for recreation facilities and visitor centers needs strengthening.	FY 85
Recreation projects involving cost-sharing partners were not managed effectively.	FY 85
Combat Development Activities	
Requirements determination procedures were not adequate.	FY 87

Financial Management	Completion Date
Management studies, program reviews, and analysis of contracted functions are weak due to a lack of definitive guidance and trained personnel to perform the review and analysis functions.	FY 86
There is currently no standard method to analyze the cost-effectiveness of proposed warranties for weapon systems and major components.	FY 85
Need improved control over interest rates charged to retirees for debts owed the Army.	FY 86
Inadequate verification of travel documentation and slow recoupment of travel advances.	FY 86
Error rates are too high and quality of service is too low in some segments of the Army's system for paying reservists.	FY 85
Need to upgrade quality assurance program in the Corps of Engineers.	FY 85
Inadequate scrutiny of selected special mission funding.	FY 85
Health Care	
Radiation protection program needs improvement.	FY 85
Management oversight and operating procedures applicable to health care in Defense facilities were not adequate.	FY 85

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Material Weakne Requiring Corrective Actions (FY 1984)

Facilities Support	Completion Date
Contingency plans for emergency utility support in European military communities were not adequate and could adversely affect combat readiness during emergencies.	FY 84
Housing	
Unaccompanied personnel housing is not properly allocated.	FY 85
Information Management	
ADP equipment preventive maintenance is inadequate.	FY 85
ADP management policies and practices require strengthening.	FY 86
Costs incurred for leased telephone systems obtained through Federal/State communications agreements were not proper.	FY 85
Intelligence Activities	
Accurate threat data were not used in justifying new material developments and in updating training programs.	FY 85
Maintenance Activities	
Outdated prices cause maintenance delays.	FY 85

Health Care (continued)	Completion Date
Command approval was not always obtained when doctors accept outside employment.	FY 85
Supply Activities	
Equipment requirements are not properly determined.	FY 86
The M55 Rocket Disposal Program presents hazards.	FY 89
The recovery improvement program reporting system needs to be more proactive.	FY 86
Much of the war reserve materiel (Defense Logistics Agency managed items), susceptible to deterioration as it ages, is unnecessarily stored in Army depots.	FY 85
Weaknesses in reporting and analysis in materiel receipt.	FY 85
Conflicting regulatory guidance over definition of equipment in place versus installed equipment.	FY 85
Weaknesses in tools accountability.	FY 85
Support Services	
Pertinent Army regulations and management information systems are not adequate for implementing requirements and for reporting the results of operations.	FY 86
Appropriated fund support provided to club systems was either inadequately documented or unauthorized.	FY 85
Physical control over assets, including meat and cash, are not adequate.	FY 88

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Material Weaknesses Requiring Corrective Actions (FY 1984)

	Completion Date
Maintenance Activities (continued)	
The Army is over calibrating some test equipment by following manufacturer specifications rather than considering how the items are actually used.	FY 85
Personnel Activities	
Classification, assignment, and use of soldiers are not always in accordance with Army plans.	FY 85
Injured and long-term disabled employees are not always considered for employment in light duty or other appropriate positions.	FY 85

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GLOSSARY

We developed the following definitions that apply to our review of the implementation of the Federal Managers' Financial Integrity Act.

Accounting System

The total structure of the methods and procedures used to record, classify, and report information on the financial position and operations of a government unit or any of its funds, balanced account groups, and organizational components. An accounting system should assist in the financial management functions of budget formulation and execution, proprietary accounting, and financial reporting.

ADP Application Controls

Controls that are unique to each software application system. Application controls are intended to ensure the quality of data origination, input, processing, and output.

ADP General Controls

Controls that apply to the overall management of the ADP function in an agency. General ADP controls have a direct effect on the quality of service rendered to ADP users and cover the processing of all ADP application systems. These controls affect most ADP hardware and application software systems, and include:

--organizational controls for the ADP unit;
--system design, development, and modification controls;
--data center management controls;
--data center security controls;
--system software controls; and
--hardware controls.

These controls should be evaluated by ADP managers as part of an analysis of the general control environment.

Comptroller General's Requirements

Our Policy and Procedures Manual for Guidance of Federal Agencies contains the principles, standards, and related requirements to be observed by federal agencies. Specifically, title 2 prescribes the overall accounting principles and standards, while titles 4, 5, 6, and 7 specify requirements governing claims; transportation; pay, leave and allowance; and fiscal procedures, respectively.

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Also, agency accounting systems must include internal controls that comply with the Comptroller General's internal control standards and related requirements such as Treasury Fiscal Requirements Manual and OMB circulars.

Documentation

That information which would allow an independent reviewer to understand the rationale for conclusions the reviewer reached regarding an agency's internal controls, as well as the methods used, and personnel involved. This information should be current and be available for review. "Documentation" of internal controls is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

Internal Controls

The plan of organization and all coordinate methods and measures adopted by an agency to provide reasonable assurance that the three objectives of the Federal Managers' Financial Integrity Act of 1982 are achieved. Internal controls should be established in accordance with the Comptroller General's Internal Control Standards. Typically, an internal control represents the combination of a control objective, along with a control technique (or set of techniques) that is being relied on to achieve that control objective.

Internal Control Review

A detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost-effective manner. OMB guidelines recommend six steps for an internal control review: (1) identification of the event cycle, (2) analysis of the general control environment, (3) documentation of the event cycle, (4) evaluation of internal controls within the cycle, (5) testing of the internal controls, and (6) reporting the results. Internal control reviews should normally be conducted for those areas rated as highly vulnerable in the vulnerability assessment process, where corrective action is not readily apparent. An agency should allocate resources for these detailed reviews of internal control based on vulnerability. Those most vulnerable should be reviewed first.

Internal Control Standards

The Federal Managers' Financial Integrity Act of 1982 requires each executive agency to establish internal accounting and administrative controls in accordance with,

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among other things, standards issued by the Comptroller General. In 1983, the Comptroller General issued a set of 12 Standards for Internal Controls in the Federal Government. The standards include five general control standards, six specific standards, and an audit resolution standard. The five general standards are: (1) reasonable assurance, (2) supportive attitude, (3) competent personnel, (4) control objectives, and (5) control techniques. The six specific standards are: (1) documentation, (2) recording of transactions and events, (3) execution of transactions and events, (4) separation of duties, (5) supervision, and (6) access to and accountability for resources.

Quality Assurance

The process(es) or system(s) of an agency which provide(s) reasonable assurance that the internal control evaluation, improvement, and reporting process established in accordance with the OMB guidelines is carried out in a consistent, accurate, and reliable manner. These processes or systems will form part of the basis for the annual assurance letters and statement to the President and the Congress. An agency's quality assurance has several essential elements, including appropriate documentation for the internal control evaluation process; appropriate Inspector General role in the process; adequacy of resources and overall organization of the process; appropriate training for managers with internal control responsibilities; and assuring that actions taken will correct weaknesses permitting fraud, waste, or mismanagement.

Reasonable Assurance

Internal controls systems should provide reasonable, but not absolute, assurance that the objectives of the system will be accomplished. This concept recognizes that the cost of internal control should not exceed the benefit expected to be derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of internal controls. Errors or irregularities may occur and not be detected because of inherent limitations in any internal control, including those resulting from resource constraints, or congressional restrictions. "Reasonable Assurance" is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

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Segmentation

The process by which an agency identifies assessable units; that is, its programs and administrative functions. The inventory of assessable units developed as a result of this process must be appropriately detailed so as to provide a basis for the conduct of meaningful vulnerability assessments. OMB guidelines provide that all the agency activities, except those concerned with policymaking, should be included in the inventory. There is no single best method to segment an agency, particularly in light of variations in agency organization structure and responsibilities.

Testing Systems in Operation

Testing should be conducted on all critical system aspects and may include interviewing persons who operate the systems, observing operating procedures, examining system documentation, applying procedures on live transactions and comparing results, direct testing of computer-based systems by use of simulated transactions, and reviewing error reports and evaluating error follow-up procedures. Tests should be designed to disclose whether valid transactions are processed properly, and whether the system rejects invalid transactions. The tests should cover the entire transaction--from initial authorization through processing, posting to the accounts, and reporting. Accordingly, manual as well as automated operations should be included. In developing test plans, consideration should be given to the results of any prior system testing.

This testing criteria has been adopted by OMB and included in Appendix H of its publication, Guidelines for Evaluating Financial Management/Accounting Systems (May 20, 1985). In determining the tests that would be appropriate for any system, it is important to keep in mind that in most cases, using transaction testing as the key, more than one of the above techniques are needed to test all important aspects of an accounting system.

Vulnerability Assessment

A biennial review of the susceptibility of an assessable unit to the occurrence of waste, loss, unauthorized use, or misappropriation. OMB guidelines prescribe three basic steps for the conduct of vulnerability assessments: (1) analyze the general control environment, (2) analyze the inherent risk, and (3) perform a preliminary evaluation of existing safeguards. The primary purpose of vulnerability assessments is to determine if and in what sequence resources should be allocated for the performance of internal control reviews.

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ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

COMPTROLLER

16 SEP 1985

Mr. Frank C. Conahan
Director, National Security and
International Affairs Division
U.S. General Accounting Office
441 G. Street, N.W.
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Final Letter Report (GAO/NSIAD-85-116, OSD Case 6814)Draft Reports, "Department of Defense's Implementation of the Federal Managers' Financial Integrity Act (FMFIA)," dated July 29, 1985 (GAO Code 390017, OSD Case 6809), and related reports to the Military Departments (GAO Codes 390018 through 390020, OSD Cases 6810 through 6812) and the Defense Logistics Agency (GAO Code 390017, OSD Case No. 6813).

The DoD is pleased that the GAO acknowledged the Department's progress in successfully implementing the FMFIA. At the same time, the GAO expressed reservations as to whether the DoD had an adequate basis for reporting that the objectives of the FMFIA had been met. The GAO's reservations may be more a result of its limited evaluation criteria than uncertainties in the IMC process. Whereas the GAO generally relied on its criteria in assessing reasonable assurance, the DoD used its complete network of management systems and audits.

The DoD will continue to improve its guidance for the annual evaluation of accounting systems. The DoD, however, also will continue its view that the accounting systems provide adequate internal and fund control features and that the certified systems are in compliance with GAO accounting requirements, unless detailed audits prove otherwise. Along these lines, on May 23, 1985, the DoD issued an advance copy (to be finalized in September) of guidance requiring testing of accounting systems to assure that prescribed accounting requirements are satisfied.

Specific DoD comments on each of GAO's findings and recommendations are enclosed. The DoD appreciates GAO efforts in assisting the DoD to meet the requirements of the FMFIA. Thank you for the opportunity to comment on the draft reports.

Sincerely,

John R. Quetsch

John R. Quetsch
Principal Deputy Assistant Secretary of Defense
(Comptroller)

Enclosure

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GAO DRAFT REPORT - DATED AUGUST 7, 1985
(GAO CODE 390018 - OSD CASE 6810)

"THE DEPARTMENT OF THE ARMY'S IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)"

DOD COMMENTS

* * * * *

FINDINGS

o **FINDING A: Strong Management Commitment Results In Many Weaknesses Being Reported.** GAO reported that Army managers are committed to the FMFIA Program and are willing to report material weaknesses and planned corrective actions. GAO found, however, that because of the interim status of the FMFIA Program, most of the weaknesses were identified by Army managers using sources other than internal control reviews, such as management reviews and published audit reports. Although legitimate sources; GAO concluded that when they are the primary source, it does not believe they provide an adequate basis to assure the requirements of the act have been met. GAO also found that, because of the Army's method of reporting (rolling up weaknesses for installations through major commands to the Secretary of Army), many of the individual weaknesses identified are location-specific. GAO concluded that when these individual weaknesses are put together, however, they represent many of the major issues confronting the Army today. GAO noted that due to limitations in its audit scope, it could not evaluate the effectiveness of the other part of the process, i.e., corrective actions taken on an Army-wide basis to "fix" the weaknesses identified. GAO pointed out, however, that the various commands it visited were taking actions to correct local problems. (Pages 3-6)

DoD Response: Partially concur. DoD disagrees with the conclusion that the Army program used sources such as management reviews and audit reports as the primary source for determining the status of internal controls. Audits and inspections, often requested by management to use the most skilled evaluators for complex analyses, should continue to be a primary source for identifying material weaknesses. This is not an indication that the "new" internal control review system is not performing adequately. In conjunction with the 51 Army material weaknesses identified in 1984, Army accomplished a broad array of evaluations, including 62,000 vulnerability assessments and 17,000 internal control reviews. Army also corrected 3,600 internal control

Note: Where applicable, the page numbers have been changed to correspond to those in this report.

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weaknesses. The Army will continue to operate a decentralized, along with a centralized, internal control system until most of the checklists have been completed. While audits and inspections are a primary source of identifying material weaknesses, the overall status of internal controls is determined from comprehensive actions by managers throughout the Army. The US Army Audit Agency performed evaluations at 37 Army organizations and concluded that Army continued reasonable and prudent actions to implement requirements of the FMFIA and OMB Circular A-123.

- FINDING B: Problems With Army's Evaluation Program. GAO found that during FY 1984, the Army's internal control evaluation program was in a year of transition. As a result of moving from a decentralized evaluation program to a centralized one, the GAO found that inconsistent and unclear guidance impeded the success of the program. GAO also found that implementation problems caused a lack of supporting documentation for vulnerability assessments, and caused only a few locations to establish tracking and followup systems. Army did not specifically assign responsibility for tracking and followup, and GAO concluded that guidance must specifically assign responsibility for followup if the Army expects to achieve its goals for the new internal control program. GAO found, to be of most importance, the Army's failure to provide adequate guidance for defining subfunctions and assessable units that could result in these not being reviewed and potential weaknesses remaining undetected. GAO pointed out, however, that the revised internal control program regulations issued in April 1985, should correct these procedural problems. GAO also found that the Army did not adequately evaluate its ADP internal controls during 1984. For a considerable time during the year the process and procedures to review the controls, GAO noted, did not exist. GAO, however, concluded that the recent assignment of ADP responsibilities to the Assistant Chief of Staff for Information Management, should resolve most of the problems. GAO also concluded that the Army's planned adoption of the ADP systems control guidelines issued by OSD should help resolve the procedural problems. (Pages 2-3, 6-7, 17-20)

  DoD Response: Partially concur. The DoD does not concur with the implication that the Army now operates a centralized evaluation program only. The Army will continue to operate a decentralized, along with a centralized, internal control system until most of the checklists have been completed. This provides the Army with a better basis for making a determination with respect to reasonable assurance.

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The DoD also disagrees with the indicated problems involving Army's tracking and followup systems. Rather than have Army staff organizations, major commands, and other organizations develop automated individual tracking and followup systems, Army decided to centrally develop a fully integrated system for use by all. The automated system, initiated in 1984 and scheduled to be operational by the end of 1985, is being contractually developed under direction of the Army Internal Control Office. The system covers the needs addressed by the GAO and provides an audit trail from Army centralized records to the lowest level organization. In the interim, Army has relied on its existing audit report tracking and followup system, together with centralized actions by designated Army functional proponents and the Army Internal Control Office to ensure tracking and correction of material weaknesses. The interim system has been effective. The computerized management information system will permit control over all program matters, including disposition of all reported internal control weaknesses.

As indicated in the Secretary of the Army's Annual Assurance Statement, greater management emphasis has been placed on the importance of adequately evaluating the general and application controls for automated systems. The Department of the Army has been reorganized to establish a new Assistant Chief of Staff for Information Management and a major command for the management of information systems. The Army also participated in a DoD working group that developed guidelines on how ADP management control reviews should be accomplished. Emphasis will continue until the process for the evaluation of general and application controls for automated systems has been fully implemented. The "planned adoption of the ADP systems control guidelines issued by OSD" was implemented through two separate Army channels in 1984.

- **FINDING C: Status Of Accounting Systems.** GAO noted that the Army reported having 2 accounting systems; one for military and another for civil works. GAO also noted that in FY 1984, the Army (1) developed a comprehensive inventory of its accounting subsystems, and (2) initiated a comprehensive evaluation (including testing) of all of its accounting systems to determine whether they conform with the Comptroller General's requirements. GAO additionally noted that for FY 1984, the Army reported significant problems within the military accounting systems, but reported the civil works accounting systems and 20 of the 66 military subsystems to be substantially in conformance with the Comptroller General's requirements. GAO agreed that the Army correctly cited the major problems in the military accounting system, and noted that Army plans to correct those problems with a major system redesign. GAO found,

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however, that the Army had not allowed enough time and had not issued evaluation instructions until late in the year. GAO concluded that, as a result, the evaluations were inconsistent and incomplete. Because of the inconsistent and incomplete evaluations and limited testing, GAO concluded that the military subsystems and the civil works system should not have been reported as being in conformance with the Comptroller General's requirements. (Pages 7-8, 21-24)

DoD Response: Nonconcur. DoD disagrees with the conclusion that the Army evaluations did not provide reasonable assurance. The Army made significant progress in implementing Section 4 of the FMFIA during its second year. Final Army guidelines for evaluating and reporting on accounting systems were published on July 18, 1984, just 30 days after the joint GAO/OMB meeting with Executive agency officials to present FY 1984 expectations. The Army procedures, in compliance with OSD guidelines, required an evaluation and report on each operating accounting system by the responsible system manager. Individual system evaluations were performed concurrently, mutually exclusive from one another. The extent of each system evaluation depended upon the degree of known system compliance (or noncompliance) with GAO standards. Under this methodology and because of the nonexistence of a central evaluation team, there was no need, nor means, to prioritize systems for sequential reviews.

Based on the system evaluations, the Army report accurately presented the status of its operating accounting systems. The evaluation process provided reasonable assurance to correctly conclude that 20 of the 66 Army accounting subsystems substantially complied with the GAO accounting standards and that the remaining 46 subsystems had adequate financial control and reporting features to support the Army in accomplishing its fiscal accounting responsibilities. One of the management indicators considered in the Army's determination was that 15 of the 20 subsystem designs had been GAO approved.

The Army took a positive approach to the accounting systems evaluation and reporting process. Testing of systems, already known to not be in compliance with prescribed accounting standards and scheduled for replacement, would clearly have been a waste of resources. The effectiveness of Army's fiduciary accounting controls was demonstrated in a variety of ways. A reduction in the number of Anti-Deficiency Act violations over recent years was one management indicator of internal control effectiveness (e.g., Army reported only one violation in FY 1984 compared to 89 violations reported during FY 1975 through FY 1980).

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Also, the Army conducted more accounting systems testing than the GAO auditors recognized, through the normal validation testing conducted for system changes and through internal control reviews of accounting functions.

The 66 Army accounting subsystems were consolidated into 2 composite systems -- military and civil works. The boundaries of the civil works accounting systems were correctly stated in the second paragraph, page 30, of the GAO draft report as limited to being part of the Corps of Engineers Management Information System. The remaining portion of the Corps of Engineers Management Information System, together with 65 other accounting subsystems (including the Corps of Engineers Payroll System), comprised the military accounting system. As regards the Corps of Engineers Management Information System, problems reported by the Army Audit Agency early in FY 1985 (i.e., Advisory Report: SW 85-A2) will be considered in FY 1985 determinations as to whether the civil works accounting system is in conformance.

o **FINDING D: Tracking And Followup System.** GAO found that the Army's follow-up system for tracking accounting systems deficiencies and related corrective actions is a manual system with limited information. GAO noted that Army officials, recognizing the need for a better system, have requested ADP equipment to support the follow-up system. GAO concluded that, at a minimum, the following information should be included in the automated system: (1) the deficiencies in systems and subsystems, (2) planned corrective actions including system replacement plans, (3) the office responsible for the corrective actions, (4) interim and final milestone dates for the corrective actions, (5) slippages of scheduled corrective action work, and (6) identification of whether the action taken actually corrected the deficiency. (Page 9)

DoD Response: Partially Concur. The DoD would fully concur with this finding if the word "automated" were not included in the eighth line of the finding. During FY 1983, Army management recognized a need for a system to help track accounting systems deficiencies and corrective action plans. A contractually supported project was started in FY 1984, to develop a computerized tracking and follow-up system of both Sections 2 and 4 of the FMFIA. That portion of the overall system applicable to Army accounting systems is scheduled to be operational in 1986. Automated system specifications are being developed based on perceived Army needs. Although the automated portion of the system may not include all the information suggested by GAO, the overall system will.

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RECOMMENDATIONS

- **RECOMMENDATION 1:** GAO recommended that the Secretary of the Army not report that the Army's systems of internal accounting and administrative control meet the requirements of the FMFIA until the evaluation program has developed to the point where a coordinated Army-wide analysis of all functions is performed. (Page 11)

  DoD Response: Nonconcur. The FMFIA and implementing Army program seek reasonable assurance that internal controls are adequate. That assurance was provided by the actions and accomplishments defined in the Secretary of the Army's 1984 Annual Statement on Internal Controls. The Army will continue to operate a decentralized, along with a centralized, internal control system until most of the checklists have been completed. The broad array of program accomplishments, including 62,000 vulnerability assessments and 17,000 internal control reviews, together with assurances given by heads of organizational units who also considered the results of audits, inspections, checklists, and other verification processes, provided reasonable assurance that Army internal controls were adequate, in place, and operative. The US Army Audit Agency performed related verification work at 37 Army organizations and concluded that the Army continued reasonable and prudent actions to implement the requirements of the program. Also, Table 1-1 of Army Regulation 11-2 identifies the Army staff proponent for each function and subfunction to ensure coordinated coverage of all internal controls. The Army staff proponents performed centralized vulnerability assessments for all functions and are developing checklists consistent with the vulnerability assessment ratings. In the interim, the ratings have been provided to all major commands to ensure interim coverage of areas rated highly vulnerable. The evolving strength of Army's programs is evident in the fact that 22,785 internal control reviews were performed in the first half of FY 1985, compared to 17,000 in all of FY 1984. The overall program continues to mature consistent with FMFIA requirements.

- **RECOMMENDATION 2:** GAO recommended that accounting systems not be reported as (1) being in conformance with the Comptroller General's requirements and (2) providing adequate financial control and reporting features to support the Army's fiscal accounting responsibilities until they have been tested in operation. (Page 11)

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DoD Response: Nonconcur. During 1984, Army developed and implemented a very comprehensive and sound methodology for identifying, evaluating, and reporting on operating accounting systems. Based on aggressive second year FMFIA actions, Army accurately presented the status of its operating accounting systems. The evaluation process provided reasonable assurance to correctly conclude that 20 of the 66 Army accounting subsystems substantially complied with the GAO accounting standards and that the remaining 46 subsystems had adequate financial control and reporting features to support the Army in accomplishing its fiscal accounting responsibilities. The US Army Audit Agency, in Report No. 85-703, concluded that "... a sound methodology was developed to support a conclusion on whether the Army's accounting and financial system components conform with the principles, standards, and related requirements prescribed by the Comptroller General."

The Army took a positive approach to the accounting systems evaluation and reporting process. Testing of systems, already known to not comply with prescribed accounting standards and scheduled for replacement, would clearly have been a waste of resources. The effectiveness of Army's fiduciary accounting controls was demonstrated in a variety of ways. For example, a reduction in the number of Anti-Deficiency Act violations over recent years was one management indicator of internal control effectiveness. Army reported only one violation in FY 1984 compared to 89 violations reported during FY 1975 through FY 1980.

Although Army was satisfied with the FMFIA Program in 1984, additional improvements will continue. For example, the FY 1985 instructions to Army accounting systems managers emphasized testing as a key element in the evaluation of those systems planned to be reported in compliance with the prescribed standards.

- **RECOMMENDATION 3:** GAO recommended that the Secretary of the Army direct that:

  -- An accounting systems review plan be devised which will prioritize subsystems reviews according to such relative risks as when the subsystems will be replaced and the subsystems' significance to the Army's total fiscal responsibilities.

  -- A comprehensive tracking and followup system be established and used to assure correction of accounting systems deficiencies before the systems are reported in conformance.

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-- The civil works accounting system not be reported as in conformance until known system problems are corrected and the related civilian pay system is brought into conformance. (Page 11)

DoD Response: Partially concur.

-- DoD disagrees with the need to have the Army devise a prioritized accounting system review plan as described in the draft GAO report. The Army currently requires an annual evaluation and report on each system by the responsible manager. The level of evaluation depends on whether the system is planned to be reported in conformance. Army accounting systems evaluation criteria provide for a lesser evaluation of systems known not to be in conformance and scheduled for replacement. Individual systems evaluations are performed concurrently and mutually exclusive from one another, therefore negating the requirement for a single prioritized listing.

-- DoD agrees with the need for an Army followup and tracking system, but reserves final decision on system specification. During FY 1983, Army management recognized a need for a system to help track accounting systems deficiencies and corrective action plans. A project was started in FY 1984, to develop a computerized tracking and follow-up system for both Sections 2 and 4 of the FMFIA. The system is scheduled to be operational by the end of 1986 for accounting systems. Automated system specifications are being developed based on perceived Army needs. Although the automated portion of the system may not include all the information recommended by GAO, the Army's overall system will include all of GAO's information requirements.

-- DoD agrees that known problems with the the Army's civil works accounting system must be considered in determining system conformance for FY 1985.

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